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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, A. D., 1947

No. 328

ADAMSTON FLAT GLASS COMPANY,
A CORPORATION, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT AND BRIEF IN SUPPORT OF PETITION.

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September, 1947.

INDEX

SUBJECT INDEX

TABLE OF CASES CITED

TABLE OF STATUTES CITED

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Petitioner, Adamston Flat Glass Company, a corporation, petitioner in the United States Circuit Court of Appeals for the Fourth Circuit, respectfully prays that a writ of certiorari issue to review a judgment of the United States Circuit Court of Appeals for the Fourth Circuit entered in this case on June 5,

1947, affirming an order of The Tax Court of the United States entered August 5, 1946.

It has been stipulated by the parties that, for the purpose of this petition for writ of certiorari, the printed record may consist of the following:

1. Appendix to petitioner's brief in the United States Circuit Court of Appeals for the Fourth Circuit.

2. The proceedings had before the United States Circuit Court of Appeals for the Fourth Circuit.

For convenient reference, an appendix is annexed to the brief in support of this petition which includes the statutes here involved, the opinion of the Circuit Court in this case, and the opinion of the Circuit Court of Appeals for the Sixth Circuit in *Muskegon Motor Specialties Company v. Commissioner of Internal Revenue*, 134 F (2d) 904 (Cert. denied 320 U. S. 741, 88 L. Ed. 440). Reference to this appendix will be (App. ....).

OPINIONS BELOW

The opinion of The Tax Court of the United States is a part of the record (R. 130) and is reported in 7 T. C. No. 61. The opinion of the Circuit Court of Appeals is a part of the record (R. 152) and is also reproduced in the Appendix to the brief filed in support of this petition (App. 31), but has not yet been officially reported.

JURISDICTION

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the act of February 13, 1925, (28 U. S. C. A. §347).

The judgment of the Circuit Court of Appeals was entered on June 5, 1947.

STATUTES INVOLVED

The issues raised in this petition involve the construction and application to the facts in this case of Section 113(a)(7)(A), Internal Revenue Code (26 U. S. C. A. §113).

The basic issue in the case, the basis for depreciation of certain of petitioner's assets, must be determined by reference to Section 114(a), Internal Revenue Code (26 U. S. C. A. §114), which refers to Section 113(b), Internal Revenue Code (26 U. S. C. A. §113), but the issues raised in this petition must be determined under Section 113(a) (7)(A). Section 203 (h)(1)(A), Revenue Act of 1926 (26 U. S. C. A., Internal Revenue Acts, 1940 Edition p. 150, Revenue Act of 1926, c. 27; 44 Stat. 12) was involved in the proceedings below.

SUMMARY STATEMENT OF THE MATTER INVOLVED

The material facts are presented in some detail in the opinion of the Circuit Court, reproduced in the appendix hereto, and in the findings of fact made

by the Tax Court (R. 131). Condensed for the purposes of this petition, the nature of the proceeding and the facts of the case are as follows:

Nature of the Proceeding

The Commissioner of Internal Revenue determined deficiencies in income taxes against petitioner for the calendar years 1940, 1941, 1942 in the aggregate sum of $2,522.80, while petitioner claims overassessments for those years in the aggregate amount of $34,643.58. The asserted deficiencies were founded upon use by the Commissioner of cost to petitioner as the basis for depreciation of certain assets formerly belonging to Clarksburg Glass Company (hereinafter referred to as Clarksburg) acquired by petitioner in 1926. Petitioner claims said assets were acquired in connection with a statutory reorganization, as defined by the Revenue Act of 1926, and that it is entitled to use as the basis for depreciation of those assets the same basis applied to the properties in the hands of the former owner.

Section 114(a), Internal Revenue Code, states that the basis for depreciation of property shall be the adjusted basis provided in Section 113(b) for the purpose of determining the gain upon the sale or other disposition of such property. Section 113(b), Internal Revenue Code, states that the adjusted basis for determining the gain or loss from the sale or other disposition of property shall be the basis determined under subsection (a), adjusted as provided in subsection (b). Section 113(a), In-

ternal Revenue Code, provides that the unadjusted basis of property shall be the cost of such property; except that

> "* * *
>
> "(7) Transfers to corporation.—If the property was acquired—
>
> "(A) After December 31, 1917, and in a taxable year beginning before January 1, 1936, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, or
>
> * * *
>
> then the basis shall be the same as it would be in the hands of the transferor * * *."

Petitioner instituted these proceedings in the Tax Court of the United States for a redetermination of the deficiencies. The Tax Court, in its opinion (R. 147), assumed, without deciding, that the 50 per cent. interest in the property remained, after the transfer, in creditors of the old corporation, "or any of them", within the statutory language, but held that there was no reorganization and entered decision finding deficiencies in petitioner's tax for the years involved in the amounts assessed by respondent (R. 150).

Upon petition for review filed by petitioner in the Circuit Court of Appeals for the Fourth Circuit, that Court, in its opinion (App. 39), found that there

was a reorganization and that petitioner acquired the properties in connection with that reorganization but nevertheless affirmed the decision of the Tax Court because it found the transfer to the taxpayer in connection with the reorganization did not meet the requirement of Section 113(a)(7)(A) of the Internal Revenue Code that "immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them" (App. 40). The basis for this latter conclusion was that the statutory language above quoted requires that those persons who acquire a 50 per cent. interest or control in the properties after the transfer must have had at least a 50 per cent. interest or control before the transfer (App. 46).

If it shall be held that petitioner is entitled to use as the basis for depreciation of the assets here involved the basis applied to the assets in the hands of Clarksburg Glass Company, it has been stipulated that the depreciation deductions for the years involved shall be computed in accordance with Rule 50 of The Tax Court's Rules of Practice and are to be based upon the figures contained in Exhibit 26 attached to the Stipulation of Facts (R. 26).

Facts

A summary statement of the facts pertinent to the questions presented in this petition follows.

Prior to January 1, 1926, Clarksburg Glass Company, the former owner of the properties the basis

for depreciation of which is here involved, experienced financial difficulties. Its properties were encumbered with a first mortgage securing notes in the aggregate amount of $150,000 payable one each year over a period of years, and with a second mortgage securing notes payable to Pittsburgh Plate Glass Company in the aggregate amount of $100,000, the entire amount of which, due to an acceleration clause, became payable January 1, 1926, upon default in payment of the note due on that date.

Pittsburgh Plate Glass Company instituted proceedings to foreclose its mortgage in January, 1946, seeking a sale of the properties subject to the first mortgage. Stockholders of Clarksburg and its principal unsecured creditor, Clarksburg Flat Glass Company, a company which had been formed in 1925 to consolidate Clarksburg and American Sheet Glass Company and whose sole assets were unsecured notes of Clarksburg evidencing advances made by Clarksburg Flat Glass Company from the proceeds of the sale of its capital stock to meet operating expenses of Clarksburg, immediately began negotiations with Pittsburgh to work out a plan whereby those interested in the two companies might forestall foreclosure and retain the properties. The outcome of these negotiations was a plan whereby Pittsburgh would buy in the properties at the foreclosure sale and would then transfer the properties to a new corporation to be formed by the stockholders and creditors of Clarksburg who were interested in retaining the properties, the new company to assume the first mortgage and pay Pittsburgh just enough

to cover its out of pocket expenses in connection with the foreclosure and reduce the amount of its indebtedness by one-third, the remaining two-thirds to be covered by notes of the new company—in other words to make Pittsburgh come out whole on the transaction and no more. Petitioner was incorporated in June, 1926, as the new company to which the properties would be transferred. The plan was consummated and petitioner acquired the properties here involved in connection with that plan of reorganization.

Prior to the reorganization Clarksburg had outstanding 18,215 shares of voting stock and 3,061 non-voting shares, of which twelve shareholders owned 8,605 voting and 739 non-voting shares. These twelve stockholders acquired 754 of the 1500 shares of stock issued by petitioner. Thus stockholders who owned 44 per cent. of all the shares and a little more than 47 per cent. of the voting shares of Clarksburg before the transfer owned a little over 50 per cent. of the stock of Adamston after the transfer (compare list of stockholders of Clarksburg (R. 62) with list of stockholders of Adamston (R. 67) and also see opinion of Circuit Court (App. 43). The Circuit Court held that the claims of creditors of Clarksburg may not be taken into account in deciding the issue, and since petitioner will not raise that point in this petition, figures indicating the percentage of indebtedness of Clarksburg prior to the reorganization held by creditors of Clarksburg who became stockholders of petitioner after the transfer will not be included in this statement. But, although

it is not necessarily pertinent to the issues herein raised, it is worthy of note that of the 1500 shares issued by petitioner, 1289 shares were acquired by persons formerly interested in the properties in one capacity or another. (R. 145).

QUESTIONS PRESENTED

The questions herein presented are:

(1) Where a corporation acquires property in connection with a reorganization, does the provision of Section 113(a)(7)(A) of the Internal Revenue Code that "immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them" require that those persons who possess a 50 per centum interest or control in the properties after the transfer must also have had at least a 50 per centum interest or control in the properties prior to the transfer?

(2) Where there is a sufficient continuity of interest in a transaction to meet the requirements of a statutory reorganization, if a substantial part of those who held an interest or control in the properties transferred prior to the transfer possess a 50 per centum interest or control in the properties after the transfer, are not the provisions of Section 113(a)(7)(A) complied with so that the transferee is entitled to use as its unadjusted basis for depreciation of the properties so transferred the basis applied to the properties in the hands of the transferor?

(3) Did the Circuit Court err in affirming the decision of the Tax Court?

REASONS RELIED ON FOR THE ALLOWANCE OF A WRIT

(1) The decision of the Circuit Court of Appeals for the Fourth Circuit in this case is in conflict with the decision of the Circuit Court of Appeals for the Sixth Circuit in *Muskegon Motor Specialties Co.* v. *Commissioner of Internal Revenue*, 134 F. (2d) 904, (Cert. denied 320 U. S. 741, 88 L. Ed. 440).

(2) The Circuit Court of Appeals has decided in this case an important question of federal law which has not been, but should be settled by this Court, and the decision of the Circuit Court is wrong.

Wherefore, your petitioner respectfully prays that a writ of certiorari issue under the seal of this Court, directed to the United States Circuit Court of Appeals for the Fourth Circuit, commanding that Court to certify and send to this Court a full and complete transcript of the record and all of the proceedings of the said Circuit Court had in the case numbered on its docket No. 5570 and entitled "Adamston Flat Glass Company, Petitioner v. Commissioner of Internal Revenue, Respondent," to the end that this cause may be reviewed and determined by this Court as provided for by the statutes of the United States; and that the judgment of the Circuit Court of Appeals for the Fourth Circuit may be reversed by this Court, and that your petitioner may have such other

and further relief in the premises as to this Court may seem proper.

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Counsel for Petitioner.

WILLIAM M. DRENNEN,
JACKSON, KELLY, MORRISON & MOXLEY,
Of Counsel for Petitioner.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

OPINIONS OF COURTS BELOW AND JURISDICTION

Reference has been made in the petition to the opinions of The Tax Court of the United States and The Circuit Court of Appeals for the Fourth Circuit filed in this cause and will not be repeated here.

Statements as to jurisdiction have also been made in the petition and are incorporated by reference herein.

STATEMENT OF THE CASE

A summary statement of the case has already been made in the preceding petition, which is hereby adopted and made a part of this brief.

In order to more clearly point up the issues involved in this case petitioner wishes to emphasize that it appears from the record and the opinion of the Circuit Court that petitioner acquired properties formerly belonging to Clarksburg Glass Company pursuant to a plan of reorganization and in connection with a reorganization as defined by the applicable statute effective in 1926, the year in which the transfer of assets occurred; that a little more than 50 per cent. of all the stock subscribed for and issued by the petitioner prior to and immediately after the transfer was subscribed for and issued to stockholders of Clarksburg Glass Company, the transferor; that the opportunity to acquire stock of peti-

tioner and go along with the reorganization was offered to all stockholders of Clarksburg and its principal unsecured creditor, Clarksburg Flat Glass Company, and in fact all were urged to go along (R. 51); that twelve stockholders of Clarksburg, most of whom were otherwise interested in the properties as stockholders of Clarksburg Flat Glass Company or direct creditors of Clarksburg, who held a little more than 47 per cent. of the voting stock and 44 per cent. of all the stock of Clarksburg Glass Company, acquired more than 50 per cent. of the stock issued by petitioner and thus effectively continued the management and control of the properties and their investments (R. 51, 95 *et seq.*)

SPECIFICATION OF ERRORS

(1) The Circuit Court erred in holding that the provision of Section 113(a)(7)(A) of the Internal Revenue Code that "immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them" requires that those persons who possess a 50 per centum interest or control in the properties after the transfer must also have had at least a 50 per centum interest or control in the properties prior to the transfer.

(2) The Circuit Court erred in holding that where there is a sufficient continuity of interest in a transaction to meet the requirements of a statutory reorganization and a substantial part of those who held an interest or control in the properties

transferred prior to the transfer possess a 50 per centum interest or control in the properties after the transfer, the transferee is not entitled to use as its unadjusted basis for depreciation of the properties so transferred the basis applied to the properties in the hands of the transferor under the provisions of Section 113(a)(7)(A), Internal Revenue Code.

(3) The Circuit Court erred in affirming the decision of the Tax Court entered in this case.

ARGUMENT

Summary of Argument

POINT I—The decision of the Circuit Court is in conflict with the decision of the Circuit Court of Appeals for the Sixth Circuit in *Muskegon Motor Specialties Co.* v. *Commissioner of Internal Revenue*, 134 F.(2d) 904 (Cert. denied 320 U. S. 741, 88 L. Ed. 440).

POINT II—The Circuit Court decided in this case an important question of federal law which has not been, but should be, settled by this Court.

Point I

The decision of the Circuit Court is in conflict with the decision of the Circuit Court of Appeals for the Sixth Circuit in *Muskegon Motor Specialties Co.* v. *Commissioner of Internal Revenue.*

The opinion of the Circuit Court in this case and of the Sixth Circuit Court in the *Muskegon* case are

printed in the appendix to this brief for ready comparison.

The Circuit Court decided this case against petitioner on the ground that the words in Section 113 (a)(7)(A) of the Code, "immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them" mean that those who hold a 50 per cent. interest or control in the new corporation after the transfer must also have had a 50 per cent. interest or control in the old corporation prior to the transfer; and that although former stockholders of Clarksburg held more than 50 per cent. of petitioner's stock after the transfer, they had held less than 50 per cent. of the Clarksburg stock, and therefore petitioner must use as its basis for depreciation the cost to it of the assets acquired from Clarksburg. This holding is directly in conflict with the decision of the Circuit Court of Appeals for the Sixth Circuit in the case of *Muskegon Motor Specialties Co.* v. *Commissioner of Internal Revenue*, *supra*, holding that the requirements of a similar section in the Revenue Act of 1932 are met where *any* of the persons who were stockholders of the corporation owning the property prior to the transfer have an interest or control of 50 per centum or more in the property after the transfer.

The Circuit Court recognizes that its decision on this point is in conflict with the holding of the Sixth Circuit Court in the *Muskegon* case. In the opinion in this case it is stated (App. 48) "* * * In *Muskegon Motors Specialties Co.* v. *Commissioner*, 6 Cir.,

134 F. (2d) 904, however, such a statute was thought to be satisfied although a majority interest in one of two transferring corporations was seemingly not preserved in the transferee."

In the *Muskegon* case, two companies, M and G., were consolidated into taxpayer under a plan of reorganization. As a result of the reorganization 60% of the issued (40% of the authorized) common stock of the new corporation was acquired by persons who had held practically all of the stock of M. company prior to the reorganization. But the only stockholders of G. company who acquired stock in the new corporation were the president and his wife. They held 560 of the 2000 outstanding shares of said G. company prior to the reorganization, or 28% thereof, and acquired 25% of the issued (18-2/3% of the authorized) common stock of the new corporation.

In that case the Commissioner contended that the transaction constituted a reorganization within the definition in Section 112(i)(1)(A) of the Revenue Acts of 1928 and 1932 (which definition was the same in Section 203(h)(1)(A),[1] of the Revenue Act of 1926 applicable to the transaction here involved) and that by virtue of Section 113(a)(7) of the Revenue Act of 1932, which for practical purposes is identical with the provisions of Section 113(a)(7)

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[1]Section 203(h)(1)(A), Revenue Act of 1926.

"(h) as used in this section and sections 201 and 204—

"(1) The term 'reorganization' means (A) a merger or consolidation (including the acquisition by one corporation of * * *, or substantially all of the properties of another corporation), * * ."

(A), Internal Revenue Code, the new company must use as the basis for depreciation of the assets transferred the basis in the hands of the two old companies. The Circuit Court agreed with the Commissioner, concluding that the transaction established a reorganization within the meaning of Section 112(i)(1)(A) and also that the transaction was within the provisions of Section 113(a)(7).

In its opinion in that case the Sixth Circuit Court discussed at length the phrase "immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them." We quote from that opinion (App. 59): "* * * But the statute does not enact that 50 per centum control must remain in the 'same persons,' that is, in all of them; its terms are met if that quantum of control remains in 'any of them'. It matters not that all of the stockholders of the old corporations did not become common stockholders of petitioner. If 'any' who were stockholders in Gordon plus 'any' who were stockholders in Muskegon Michigan immediately after the transfer collectively control 50 per centum of petitioner, the statute is met."

The above interpretation of the identical phrase in Section 113(a)(7)(A) of the Code was the basis of petitioner's argument to the Fourth Circuit Court but was flatly rejected by that court, the opinion stating (App. 46): "We confine our attention to the interests of the Clarksburg stockholders, and must still determine whether the statute requires

that the stockholders who hold a 50 per cent. or greater interest or control after the transfer must have had at least a 50 per cent. interest or control before that event. In our opinion this question must be answered in the affirmative, for otherwise that continuity of interest which the statute was designed to meet would not prevail."

While the opinion of the Sixth Circuit Court was confined to the question whether the transferor stockholders had a 50 per centum *control* of the property after the transfer, the facts of the present case are equally strong on that point. There can be no question from the record that those stockholders of Clarksburg Glass Company who went along with the plan and acquired stock of Adamston, although they held slightly less than 50 per cent. of the stock of Clarksburg, *controlled* the properties in the hands of Clarksburg and during the receivership and retained that control even during the time title thereto was nominally in Pittsburgh Plate Glass Company and continued that control in Adamston. There can be no question that, in the present case as in the *Muskegon* case, control remained in the same persons (R. 85-99).

It is respectfully submitted that these two cases are in direct conflict. Under almost identical statutes and somewhat similar facts, at least so far as the G. company was concerned in the *Muskegon* case, both courts held that there was a reorganization but the fourth circuit in this case held that it was necessary, under the previously quoted phrase in Section

113(a)(7)(A), that those who possess a 50 per cent. interest or control in the properties after the transfer must also have held a 50 per cent. interest or control prior to the transfer, while the sixth circuit held that such was not necesary. So far as we are advised the *Muskegon* case is the most recent decision, prior to the decision in this case, directly interpreting the phrase contained in Section 113(a)(7)(A) of the Code as applied to facts similar to those in this case, and this Court has never interpreted the section, certiorari having been denied in the *Muskegon* case. The phrase has been under consideration by the Circuit Court of Appeals for the Seventh Circuit in the cases of *Monarch Electric & Wire Co.* v. *Commissioner*, 38 F. (2d) 417, *Fairbanks Court W. Groc. Co.* v. *C. I. R.*, 84 F. (2d) 18 (Cert. denied 299 U. S. 582, 81 L. Ed. 428); *Rex Mfg. Co.* v. *C. I. R.*, 102 F. (2d) 325, and *C. I. R.* v. *Bankers' Farm Mortgage Co.*, 145 F. (2d) 772. In none of those cases were the facts such as to require a determination of the precise question here involved with the possible exception of the *Rex Mfg. Co.* case, in which there was a dissenting opinion. The cases are discussed and quoted from in the opinion of the Circuit Court in this case (App. 48) and will be discussed under Point II of this argument. Suffice it to say that language used in the opinions in those cases only serves to further confuse the issue.

It is respectfully urged that the conflict and doubt arising from the two most recent Circuit Court cases should be resolved by this Court.

Point II

The Circuit Court decided in this case an important question of federal law which has not been, but should be, settled by this Court.

The Circuit Court of Appeals for the Fourth Circuit in this case decided that petitioner is not entitled to use as the basis for depreciation of certain of its assets for federal income tax purposes the basis of those assets in the hands of the former owner. This decision necessarily involved an interpretation of Section 113(a)(7)(A), Internal Revenue Code (26 U. S. C. A. §113).

As heretofore stated, we have been unable to find any cases wherein the pertinent part of Section 113(a)(7)(A) has been interpreted by this Court, nor has this Court interpreted the provision as it apeared in the Revenue Acts prior to codification of the internal revenue law. Certiorari was denied by this Court in the *Muskegon* case, *supra*, and in the *Fairbanks Court W. Groc. Co.* case, *supra*, and was apparently not sought in the other cases cited under Point I of this argument wherein the provision was involved.

The provision is in the present Internal Revenue Code, and from its nature, must remain in the Code, and it will be applicable to all reorganization transactions which occurred after December 31, 1917, and prior to January 1, 1936. It is applicable in determining not only the basis for depreciation of properties acquired in such transactions, but also in

fixing the basis for determining gain or loss on the present or future sales or other disposition of any properties so acquired.

This Court has often deemed the interpretation of the reorganization provisions in the Revenue Acts of 1924 through 1932 of sufficient importance to warrant its review. *Pinellas Ice & Cold Storage Co.* v. *C. I. R.*, 287 U. S. 462, 77 L. Ed. 428; *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378, 80 L. Ed. 284, and its companion cases; *Letulle* v. *Scofield*, 308 U. S. 415, 84 L. Ed. 355; *Helvering* v. *Alabama Asphaltic Limestone Co.*, 315 U. S. 179, 86 L. Ed. 775, and its companion cases. In most instances those cases involved the determination of the proper basis for depreciation of property acquired in reorganizations occurring at about the same time the reorganization in this case took place and were governed by similar provisions of the pertinent Revenue Act. But it having been determined what constitutes a reorganization, so as to meet the first requirement of Section 113(a)(7)(A) of the Code, that the property was acquired "After December 31, 1917, and in a taxable year beginning before January 1, 1936, by a corporation in connection with a reorganization" the taxpayer and the Commissioner of Internal Revenue are still unadvised by this Court as to what is meant by the requirement that a 50 per cent. interest or control remain "in the same persons or any of them."

Under the rule as laid down by the Fourth Circuit Court in this case there may be a sufficient con-

tinuity of a substantial and proprietary interest to come within the definition of "reorganization," but the taxpayer may still be denied the right to use the basis of the transferror—or on the other hand under different circumstances, be given the right to use a "stepped up" basis, which the reorganization provisions were designed to prevent—simply because those persons holding a little more than 50 per cent. of the stock of the old corporation refuse to go along with the plan. Conversely, the Sixth Circuit Court, in the *Muskegon* case, has held that the words "or any of them" in the statute mean that if there is a sufficient continuity of interest to be within the purview of the reorganization provisions, if any of those who held a substantial stake, although less than 50 per cent., retain at least a 50 per cent. interest or control of the properties after the transfer, so that less than 50 per cent. new capital is brought in, the transferee must use as a basis for the properties transferred the basis of the former owner, adjusted as provided in Section 113(b) of the Code.

While the Code provision here under consideration is applicable only to transactions occurring prior to January 1, 1936, the provision is a basis provision and is therefore important in current and future income tax law. It is obvious from this case, which arises out of a transaction which occurred in 1926, and from the fact that some of the above cited cases with reference to interpretation of the reorganization provisions of the Revenue Acts of 1924, 1926, 1928 and 1932 have just recently reached the Courts, that any provision of the Internal Revenue Code

fixing the basis for depreciation and for determining gain or loss may be involved in litigation for a number of years to come.

The following cases are reviewed to point out that application of Section 113(a)(7)(A) presents both a difficult problem of administration for the Commissioner of Internal Revenue and difficult problems for taxpayers, which have not been solved by the inconclusive and at times conflicting opinions of the lower courts and which would be greatly aided by an interpretation of the section by this Court as applied to the case at bar wherein the question is squarely presented whether the 50 per cent. requirement of the law means that those who hold a 50 per cent. interest or control in the new corporation after the reorganization must also have held a 50 per cent. interest or control in the old corporation, and wherein, the petitioner believes, the conclusion of the Circuit Court was wrong.

The seventh circuit appears to have decided more cases involving an interpretation of this 50 per cent. clause than any other circuit. In *Monarch Electric & Wire Co.* v. *C. I. R., supra*, prior to the transfer A. held 52 per cent interest and control, the remaining 48 percent. being in B, C and D. After the transfer B, C and D held all the common stock constituting a 52 per cent. interest and voting control and A. held all the voting preferred stock, constituting a 48 per cent. interest and voting control. All three circuit judges wrote opinions. The majority held that this met the requirements of a similar 50 per cent. statute. The third judge dissented on the

same theory used by the fourth circuit in this case, that the word "remain" means that the 50 per cent. interest or control in the new corporation must be held by the same persons who held at least a 50 per cent. interest or control before the transfer. Yet the Circuit Court in this case quotes from the majority opinions in that case in support of its conclusion. (App. 49).

In *Fairbanks Court W. Groc. Co.*, v. *C. I. R.*, *supra*, the seventh circuit considered the similar provision in the 1924 Act, except that 80 per cent. rather than 50 per cent. was required. There three companies, with no interlocking stock ownership, consolidated into taxpayer. All of taxpayer's stock was issued to all the stockholders in the three old companies in proportion to the value their interest in the aggregate properties transferred had to the total value of the properties transferred, and hence no single group held 80 per cent. of the new company. The Court held this to be compliance with the statute and stated, at page 20, "* * * We think it was the purpose of the section in question to prevent any so-called 'stepped-up' basis of valuation where no substantial amount of new capital was introduced." It will be noted that in the present case, under a 50 per cent. statute, less than 50 per cent. new capital was introduced. In the above two cases the Commissioner of Internal Revenue applied the basis of the former owners of the properties.

In *Rex Mfg. Co.* v. *C. I. R.*, *supra*, the seventh circuit again had the question before it. There former stockholders of the old company who held

more than 50 per cent. of the new company held only 48.2 per cent. of the old company stock unless the holdings of a deceased stockholder of the old company be considered. The Court held that the deceased stockholder's shares should be considered. The Commissioner in that case was on the other side of the fence and applied as a basis for the properties the cost thereof to the new corporation. Then again in *C. I. R.* v. *Bankers' Farm Mortgage Co., supra,* where the new corporation had acquired 70 per cent. of the bonds of the insolvent old corporation a year prior to the sale of the assets for cash, and acquired the remaining 30 per cent. for stock just prior to the sale, the Commissioner insisted that cost basis to the new corporation should be used on the ground that after the purchase of a 70 per cent. interest for cash, only a 30 per cent. interest could have remained in control of the property and therefore the requisite 50 per cent. interest or control could not be carried into the new corporation. In holding for the taxpayer the Court recognized that the words "or any of them" modifies the requirement that 50 per cent. interest or control in such property remain "in the same persons." The example given by the court in its opinion, as quoted by the Fourth Circuit Court in its opinion in this case (App. 48), does not necessarily solve the question here presented but lends further uncertainty to the issue as applied to the facts in this case.

In the *Muskegon* case, *supra,* the Commissioner again applied the basis of the two old corporations even though stockholders of one of the old corpora-

tions who acquired stock in the new corporation held less than 50 per cent. of the stock in the old corporation, and the sixth circuit upheld his contention. And in this case the Commissioner takes the opposite stand under somewhat similar facts. The uncertainty in the interpretation of this section is further reflected in the opinion of The Tax Court of the United States in the recent case of *Montgomery Building Realty Co.* v. *Commissioner*, 7 T. C. 417, where Commissioner used the cost basis to the new corporation, in which the Court says: "It may be that the further requirement of a 50 per cent. interest or control 'in the same persons' is not identical with the concept of continuity of interest. See Mertens Law of Federal Income Taxation, Vol. 3, §21.97. But, if not, it is difficult to see that the statutory requirement does not represent an *a fortiori* case. It permits only a 50 per cent. interest without control and appears to require merely that some of the persons interested in the new corporation be the same, at least where they represent a majority of the equity owners of the predecessor."

It is therefore respectfully submitted that the Circuit Court has in this case decided an important question of federal law, that it reached the wrong conclusion on this question, and that the question has not been, but should be, decided by this Court for the guidance of the Commissioner of Internal Revenue as well as taxpayers.

CONCLUSION

This case presents an important question of federal law which this Court has not decided and upon which there is a direct conflict of opinion in two of the most recent cases in the Circuit Courts of Appeal in which the question has been presented. It is therefore respectfully submitted that this case, wherein it is believed the Circuit Court reached an erroneous conclusion, is one calling for the exercise by this Court of its supervisory powers, by granting a writ of certiorari and thereafter reviewing and reversing the decision of the Circuit Court.

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APPENDIX

STATUTES INVOLVED

Section 113, Internal Revenue Code (26 U. S. C. A. §113).

"Sec. 113. Adjusted basis for determining gain or loss—

(a) Basis (unadjusted) of property. The basis of property shall be the cost of such property; except that—

* * *

(7) Transfers to corporation. — If the property was acquired—

(A) After December 31, 1917, and in a taxable year beginning before January 1, 1936, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, or

(B) * * *

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. * * *

(b) Adjusted basis.—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be

the basis determined under subsection (a), adjusted as hereinafter provided. * * *"

Section 114, Internal Revenue Code (26 U. S. C. A. §114).

"Sec. 114. Basis for depreciation and depletion.

(a) Basis for depreciation.—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113(b) for the purpose of determining the gain upon the sale or other disposition of such property." * * *

OPINION OF UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT IN ADAMSTON FLAT GLASS CO. v. C. I. R.

SOPER, Circuit Judge:

Review is sought of an order of the Tax Court of the United States determining deficiencies in income taxes against the Adamston Flat Glass Company in the aggregate sum of $2552.80 for the calendar years 1940, 1941 and 1942. The asserted deficiencies were founded upon the taxpayer's use of the same basis for depreciation of certain assets acquired by it in 1926 as had been applied to the properties in the hands of the former owner. Taxpayer's contention is that the properties were acquired in connection with a statutory reorganization and that it is, therefore, entitled to use the basis for depreciation of the former owner, while the Commissioner contends that the taxpayer must use the cost of the properties to it as the basis. The legal issues involved require an interpretation of Section 203(h)(1)(A) of the Revenue Act of 1926, and Section 113(a)(7)(A) of the Internal Revenue Code and a determination of the questions (1) whether there was in fact a "reorganization" whereby there was an acquisition by the taxpayer of "substantially all of the properties of another corporation", and (2) whether "immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them ***." Statutory provisions presently helpful are in the margin.*

*Revenue Act of 1926, c. 27, 44 Stat. 12 (26 U.S.C.A., Internal Revenue

Adamston Flat Glass Company, the taxpayer, was incorporated June 18, 1926, to take over the properties of the Clarksburg Glass Company, hereinafter referred to as Clarksburg. The history of Clarksburg which led up to the circumstances now under consideration is shown in the following recital. Clarksburg was organized in 1913. Prior to the year 1924, while experimenting with a new process for manufacturing glass, it encountered financial difficulties and as a consequence, on August 27, 1924, through its president, W. M. B. Sine, it entered into an agreement with the Pittsburgh Plate Glass Company, hereinafter sometimes called Pittsburgh, whereby the latter company advanced to Clarksburg the sum of $70,000 to be used to pay current notes and accounts, and agreed to advance at its discretion additional sums from time to time not to exceed $100,000 in the aggregate. By this agreement, and in consideration of the financial and operating assist-

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Acts, pp. 150-1)

"Sec. 203.

"(h) As used in this section and sections 201 and 204—

"(1) The term 'reorganization' means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation) ***."

26 U. S. C. A. §113 (Internal Revenue Code, 1945)

"Sec. 113. Adjusted basis for determining gain or loss—

(a) Basis (unadjusted) of property. The basis of property shall be the cost of such property; except that—

***

(7) Transfers to corporation. If the property was acquired—

(A) after December 31, 1917, and in a taxable year beginning before January 1, 1936, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them.

***

then the basis shall be the same as it would be in the hands of the trans-

ance rendered, Pittsburgh became actively interested in the operation of Clarksburg and received an option, never exercised, to purchase the Clarksburg properties if the then pending experiment proved successful. In September, 1924, pursuant to the agreement, Pittsburgh advanced the further sum of $100,000 secured by a second mortgage on the Clarksburg properties, which indebtedness, as of January 1, 1926, was evidenced by three notes all dated June 30, 1925, two in the amounts of $20,000 and $30,000 respectively, due on or before January 1, 1926, and one in the amount of $50,000 due on or before July 1, 1926. Of this indebtedness $70,000 was endorsed by Sine personally.

Early in 1925, for reasons of urgent financial expediency, the stockholders of Clarksburg and the stockholders of American Sheet Glass Company, another glass company operating in Clarksburg, undertook to effect a merger; and on February 9, 1925, the Clarksburg Flat Glass Company (hereinafter referred to as Flat Glass) was organized under the laws of West Virginia to take over the properties of

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feror, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. ***

***

(b) Adjusted basis. The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided. ***"

20 U. S. C. A. §114 (Internal Revenue Code, 1945)

"Sec. 114. Basis for depreciation and depletion.

(a) Basis for depreciation. The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113(b) for the purpose of determining the gain upon the sale or other disposition of such property."

***

the two companies. Shortly thereafter, Flat Glass entered into agreements with Clarksburg and the American Sheet Glass Company whereby Flat Glass obtained an option, to be exercised within six months, to acquire the respective properties in exchange for shares of its stock and the assumption of all liabilities by Flat Glass. By July 7, 1925, Flat Glass had realized approximately $200,000 from the sale of its stock which was expended in payment of obligations of the Clarksburg and American Companies. It had received notes of Clarksburg totaling $171,800. The initial Pittsburgh loan of $70,000, made under the agreement of August 27, 1924, was repaid out of this money advanced by Flat Glass to Clarksburg. Continued financial difficulties prevented consummation of the projected merger; but efforts to bring it about were continued under the direction of W. M. B. Sine and H. B. Curtin and their associates, who were large stockholders in one or more of the three companies. Sine was the president and largest stockholder of Clarksburg, and was also a large stockholder of Flat Glass and American. He was also a direct unsecured creditor of Clarksburg for a small amount. Curtin was president and the largest stockholder of Flat Glass and the holder of a past due first mortgage note of Clarksburg in the amount of $18,500.

On January 1, 1926, Clarksburg defaulted in payment of its notes due to Pittsburgh on or before that date, whereupon, by virtue of an acceleration clause, the note payable on or before July 1, 1926, also became due. On January 20, 1926, Pittsburgh insti-

tuted a suit in the District Court of the United States for the Northern District of West Virginia for the appointment of a receiver to foreclose its deed of trust. The foreclosure proceedings sought a sale of the properties subject to a first mortgage, executed by Clarksburg to W. M. B. Sine, Trustee, to secure notes in the sum of $150,000. A receiver, recommended by Sine, was appointed, and under his direction Sine operated the properties from January 22 to May 22, 1926. On April 16 judgment was entered in the equity suit in favor of Pittsburgh, providing that in default of payment within five days, the Clarksburg properties be disposed of by special commissioners at public sale in satisfaction of the Pittsburgh indebtedness and subject to the prior lien of the first mortgage. The sale took place on May 20, at which time Pittsburgh bid in the properties for the amount of its indebtedness.

Certain transactions in connection with the foreclosure of the second mortgage throw light on the taxpayer's position, which the Tax Court failed to sustain, that the purchase by Pittsburgh of the mortgaged property hereinbefore mentioned was merely a step in the plan of reorganization which the interested parties were endeavoring to put through. Prior to the suit, Pittsburgh expressed its willingness to accede to any plan that would permit Sine and his associates to retain the properties, provided Pittsburgh's debt was paid; but the attempt to raise the necessary funds failed and foreclosure followed.

In February, 1926, the annual meeting of Clarksburg was held and a committee was appointed to

arrange a general meeting of the stockholders of Clarksburg, Flat Glass and American to determine what should be done to protect their interests. In April, the committee recommended to a meeting of the stockholders of Clarksburg and Flat Glass that they form a new corporation and supply it with sufficient funds to enable it to buy the property at the sale. The name of Adamston Flat Glass Company was adopted, and Sine and J. A. McNicol were appointed trustees for the underwriters of the capital stock of the new corporation in order to obtain subscriptions to its stock. By May 17 sufficient funds had been subscribed, and on that date Pittsburgh wrote to its attorneys that it did not want the property but desired only to protect its interests and that Sine had perfected arrangements to enable him and his associates ultimately to acquire the property, and that if they should buy the property at the sale, Pittsburgh expected them to pay the notes with interest, and also the charges and costs of the sale and of the receivership; that one-third of the $100,000 with interest and the fixed charges would be paid in cash, and the remaining two-thirds of the $100,000 would be paid in two equal installments in one and two years following the sale. It was found by the Tax Court that this letter was the substance of the agreement between Pittsburgh, on one side, and Sine on the other. In this letter Pittsburgh asked its attorneys as to whether the end in view could be better effected by Pittsburgh or by Sine bidding in the property. According to the uncontradicted testimony of Sine, it was finally decided that Pittsburgh should buy the property and transfer it to the new

corporation and that the associates would make Pittsburgh whole so that it would lose nothing.

The day before the foreclosure sale to Pittsburgh, which took place on May 20, 1926, Sine deposited $33,500 with Pittsburgh's attorneys to show good faith. Pittsburgh bid in the property at the sale for $100,000 and the sale was confirmed on May 22, 1926. Pittsburgh received a deed of May 26, 1926, which recited that the consideration for the purchase was the sum of $100,000 of which amount $33,-500 was paid in cash on the day of sale, and the residue, evidenced by a note in the sum of $66,500 and bearing interest at 6 per cent. per annum, was to be paid on or before December 31, 1926. Immediately after the sale Sine took control of the plant and operated it for himself and his associates. Subsequently by letter of June 3, 1926, from Pittsburgh to Sine, and by his response under date of June 15, it was agreed that Pittsburgh would sell all the plant and property of Clarksburg to Sine for the amount of its claim against Clarksburg and in addition an amount sufficient to reimburse Pittsburgh for all payments, costs, expenses and out-of-pocket amounts arising from the foreclosure proceedings, to be paid as follows: $33,500, the amount of the cash payment made by Pittsburgh to the commissioners on the day of sale, with interest, plus the principal of $100,000 and interest on the notes due to Pittsburgh by Clarksburg, plus all of the costs of the suit, sale and receivership and counsel fees incurred therein, and any deficit in the receiver's account. It was stipulated that the offer must be

accepted and the sum of $80,000 paid within 30 days, and that within 30 days thereafter, an additional cash payment be made to reduce the total of the indebtedness to $66,666.66 for which Clarksburg was to give its notes, with interest at 6 per cent., secured by mortgage on the property. Acceptance of this agreement was made by Sine on behalf of the prospective new company. The new corporation was chartered on June 18, 1926, and became the taxpayer in this case. On June 29, 1926, a settlement was affected between it and Pittsburgh, under the terms of which Pittsburgh received the sum of $153,-969.85, which consisted of the sum of $87,303.19 in cash and two notes of $33,333.33 each, payable in one and two years respectively. A deed conveying the property to the taxpayer was executed.

Upon these facts the Tax Court reached a conclusion which, if sound, was a sufficient basis for the dismissal of the taxpayer's petition. The court held that the taxpayer did not in fact acquire all the property of Clarksburg within the meaning of Section 203(h)(1)(A) because it bought the property from Pittsburgh which had become the independent owner thereof as purchaser at the foreclosure sale, and hence the continuity of a proprietary interest between Clarksburg, the original owner, and the taxpayer, required in a reorganization under the statute, was broken.* The reasons given for this

*See *Pinellas Ice Co.* v. *Commissioner*, 287 U. S. 462; *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378; *le Tulle* v. *Schofield*, 308 U. S. 415; *Helvering* v. *Limestone Co.*, 315 U. S. 179; *Morgan Mfg. Co.* v. *Commissioner*, 4 Cir., 124 F. 2d 602; *C. M. Mead Coal Co.* v. *Commissioner*, 4 Cir., 72 F. 2d 22.

conclusion are stated in the court's opinion as follows:

> "* * * For we note, first that Pittsburgh had in mind also that if it had to buy the plant at receiver's sale, it would 'either operate the same or dispose of it, as circumstances seem to indicate'; second, that in its offer to sell on June 3, 1926, Pittsburgh set a deadline of 30 days after which its offer would be 'null and void'— not at all the act of a company obligated to be a mere transitory step in a merger, but indicative of its free and independent status as a vendor negotiating, on its own terms, a sale; and third, the record indicates that the petitioner settled with Pittsburgh for less than the amount of its claim and expenses —again showing Pittsburgh not in the position of one contracting, as a part of the original plan, to take its debt and pass the property along."

We do not think that this conclusion can be sustained, notwithstanding the finality which must be accorded to the Tax Court's findings of fact. It is based in part upon a misunderstanding of the court's own findings of fact and in part upon reasons which do not sustain it. The statement contained in the court's first reason, tnat Pittsburgh intended either to operate the plant or dispose of it, is taken from preliminary correspondence between Pittsburgh and its lawyers and was not part of the agreement between Pittsburgh and the Clarksburg interests which contemplated that Clarksburg was to acquire and operate the property. Nor is it a fact, as stated in the court's first reason, that the taxpayer settled

with Pittsburgh for less than the amount of its claim and expenses. The facts, found by the court, show that Pittsburgh suffered no loss. Moreover, it was immaterial that Pittsburgh set a time limit of 30 days within which the agreement for the transfer of the property should be effectuated. None of the circumstances indicate that there was a real break in the continuity of the transfer but, on the contrary, that the arrangement through which Pittsburgh was to acquire the property and then transfer it to Clarksburg was merely one step in an integrated transaction of the sort which has met with the approval of the Supreme Court. See *Helvering* v. *Limestone* Co., 315 U. S. 179; *Bondholders Committee* v. *Commissioner*, 315 U. S. 189. One has only to read the Tax Court's findings to realize that Pittsburgh and Clarksburg were working in complete harmony throughout to effectuate a plan whereby Pittsburgh would be made whole for its advances and a new corporation would recover the Clarksburg property free of all debts except the first mortgage.

Nevertheless, the Tax Court's decision must be sustained because the transfer to the taxpayer in connection with the reorganization did not meet the requirements of Section 113(a)(7)(A) of the Internal Revenue Code that "immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them". The case was originally presented to us upon the assumption that stockholders who held a little less than one-half of the outstanding stock of Clarksburg before the transfer acquired or held a

little less than one-half of the stock of Adamston immediately after the transfer; and hence it was conceded that these holdings did not meet the conditions of the statute. The taxpayer seeks to make good the deficiency by the contention in the first place that when both shareholders and creditors of an insolvent corporation continue their investment by taking part in a statutory reorganization and acquiring a proprietary interest in a new corporation, both shareholders and creditors should be taken into account in determining whether a 50 per cent. interest has been preserved. In the second place the taxpayer contends that even if the stockholders of Clarksburg must be excluded from the count, there remained creditors of Clarksburg who had a sufficient stake in its properties and acquired more than a 50 per cent. interest in Adamston so as to meet the statutory requirements. Authority for the theory that creditors may have a sufficient interest or control in property transferred in connection with a reorganization to satisfy the terms of the statute is found in *Helvering* v. *Limestone Company*, 315 U. S. 179, in which it was held that the continuity of interest test in a statutory reorganization was satisfied when a creditors' committee was formed which instituted involuntary bankruptcy proceedings to enforce their demands and acquired stock of a new corporation to which the assets purchased by the creditors' committee at the bankruptcy sale were transferred. In effect the court said (p. 183) that for practical purposes the creditors became proprietors when they "took steps to enforce their demands against their insolvent debtor."

The taxpayer contends that the facts of the pending case indicate that the creditors of Clarksburg had an "equity" interest in its properties which survived the transitional stage. The total indebtedness of Clarksburg on January 22, 1926, when the foreclosure proceedings were instituted, was $592,405.13, and on May 22, 1926, when the sale to Pittsburgh was confirmed, the indebtedness was $655,703.43, including on both dates the first and second mortgage debts in the aggregate sum of $250,000. The mortgage creditors acquired no stock in Adamston with the exception of H. B. Curtin, the president and a large stockholder of Flat Glass, who held one of the first mortgage notes in the sum of $18,500. Curtin was also an unsecured creditor in the sum of $3,580.75. Sine, who was president and a large stockholder of Clarksburg, was an unsecured creditor in the sum of $532.26. These two men acquired 807 out of 1500 shares of Adamston outstanding. Unsecured creditors, including Sine and Curtin, who held aggregate claims in the sum of $4,384.39, acquired 814 shares of Adamston. Flat Glass, the largest unsecured creditor of Clarksburg, held notes which, with interest, amounted to the sum of $179,810.87. Flat Glass acquired no stock in Adamston but minority stockholders of Flat Glass acquired 1,067 shares of Adamston.

These computations show that creditors of Clarksburg owned more than a majority of stock of Adamston after the transfer; but that these creditors owned only a small part of the indebtedness of Clarksburg—less than half thereof even if the debt to Flat Glass

be included—before the reorganization took place. A like situation existed as to the stockholders. Figures which have been brought to our attention since the argument in this court show that Clarksburg had outstanding 18,215 shares of voting stock and 3,061 non-voting shares of which twelve shareholders owned 8,605 voting and 739 non-voting shares. These twelve stockholders acquired 754 of the 1,500 shares of Adamston. It thus appears that shareholders who owned approximately 44 per cent. of all the shares and approximately 47 per cent. of the voting shares of Clarksburg before the transfer owned a little over 50 per cent. of the shares of Adamston after the transfer.*

Since neither the creditors nor the shareholders separately considered held a 50 per cent. interest before the transfer, an essential requirement, as we shall show, the taxpayer is relegated to the contention that the two classes may be combined for the purposes of the statute. This contention is novel, so far as we are advised, and it is difficult to imagine a situation under which it would be tenable. It is not explained how the control of the properties could be shared by both stockholders and creditors, or how the relative weight to be given the two classes of interest could be ascertained in order to determine whether

*These figures do not correspond precisely with the Tax Court's findings which showed that the stockholders of Clarksburg who remained acquired less than 50 per cent. of the stock of Adamston; but the figures are based upon lists of stockholders contained in exhibits stipulated by the parties. In view of the final conclusion we have reached, we accept the corrected figures without further reference of the case to the Tax Court.

the continuity of the required percentage had been maintained. The interests of stockholders and the interests of creditors are ordinarily in opposition to each other insofar as control of the corporate body is concerned. Shareholders of a corporation possess a proprietary interest in the corporate property, speaking in a broad rather than a technical sense, and control the corporate activities until the creditors assert their rights and take effective command, as in the case of a bankruptcy proceeding against an insolvent debtor; and when the debtor is insolvent in the bankruptcy sense, the rights of shareholders are eliminated and they may be entirely excluded from a corporate reorganization. See *Helvering* v. *Limestone Company, supra; Case* v. *Los Angeles Lumber Products Co.*, 309 U. S. 106.

We confine ourselves, however, to the situation in the pending case. The Tax Court made no finding as to insolvency of Clarksburg but assumed its existence; and we may fairly do the same, for although the book value of the assets exceeded the debts by a substantial amount when the receiver took charge and when the foreclosure sale took place, the physical assets sold for less than enough to pay the second mortgage debt and the expenses of foreclosure, and the accounts receivable were less than the accounts payable. Notwithstanding the unsatisfactory financial state of the corporation, only the second mortgage creditors asserted their right to control the properties before the transfer. These creditors were paid off; the holders of the first mortgage took no action but were content with the preservation of

their lien; and the unsecured creditors took no steps to take command of the disposition of the property.

All of the transactions which led up to the sale of the properties and the reorganization were conducted by the officers and stockholders of the corporations involved for the benefit of their shareholders. The loans by Pittsburgh to Clarksburg in 1924 were arranged by the President of Clarksburg. The ineffectual attempts at reorganization in 1925, when Flat Glass was formed, were made by shareholders of Clarksburg and American, and the formation of the taxpayer in 1926 was carried out as the result of the annual meeting of stockholders of Clarksburg in that year and subsequent joint meetings of the stockholders of Clarksburg, American and Flat Glass Companies. It cannot be said that the creditors of Clarksburg stepped into the shoes of the old stockholders in such a way as to give them the interest or control of the corporate property contemplated by the statute. It is doubtless true that the creditors, as well as the stockholders, of Clarksburg were associated in the activities which led up to the reorganization since to some extent the stockholders and the creditors were the same persons. And since both creditors and stockholders became stockholders in the new enterprise, it may be said in a broad sense that some continuity of interest by both classes survived the transfer. But we are dealing with a statute which confers a privilege upon taxpayers under certain conditions, and unless these are complied with, the basis for the computation of gains and of depreciation must be the same as that imposed upon tax-

payers generally. Hence we hold that the claims of the creditors may not be taken into account in deciding the present issue.

We confine our attention to the interests of the Clarksburg stockholders, and must still determine whether the statute requires that the stockholders who hold a 50 per cent. or greater interest or control after the transfer must have had at least a 50 per cent. interest or control before that event. In our opinion this question must be answered in the affirmative, for otherwise that continuity of interest which the statute was designated to meet would not prevail. The provision of the statute, that in case of a corporate reorganization the gain upon a sale and the depreciation from wear and tear of the property shall be estimated upon the same basis as if the property were in the hands of the transferor, was intended to take into account the actual situation and to postpone the recognition of gain or loss until it had in fact been realized. Reorganizations " *** are deemed by Congress to be transitional, continuing transactions which are not sufficiently 'closed' to justify *economically* (though there may be a different answer on a strict *legal* basis) the imposition of capital gains tax at the immediate moment of an 'ordinary business' transaction." Paul, Studies in Federal Taxation (3d Ser. 1940) 4-5. This thought is revealed in the phrase "an interest or control of 50 per cent. or more *remained* in the same persons."

If this underlying purpose of the statute is kept in mind, it will be seen that the continuance of the 50

per cent. interest in both the original owner and in the transferee is essential and that the words "or any of them" in the concluding portion of the section were used to give elasticity to the provision and make it unnecessary for persons holding or controlling a majority interest in the original owner to control precisely the same proportionate interests in the transferee. This is the view taken in a General Counsels' opinion in reference to the 80 per cent. requirement in the Revenue Act of 1926. G. C. M. 7472, IX-1, Cum. Bull, 184, 191-2 (1930). See also Mertens, Law of Federal Income Taxation (1942) §§21.97, 21.98.

The opposing argument is grounded largely on the concluding words of the requirement that a 50 per cent. interest or control in the property shall remain in the same persons or *any of them*; and it is contended that this requisite is satisfied if a majority interest is held by *any* of the stockholders of the transferor after the transfer. This contention, if given full force, would lead to the unreasonable conclusion that the ownership of a 50 per cent. interest after the transfer by one who held as little as 1 per cent. of the stock before the transfer would be sufficient. The taxpayer in the pending case, it is true, would not urge so extreme a position, but would be content with a ruling that the stockholders of the transferee should have previously held a substantial interest in the transferor. It has been held under a variety of circumstances that the rentention of a substantial rather than a controlling interest in the transferee corporation satisfies the requirement of a statutory

reorganization. *Miller* v. *Commissioner*, 6 Cir., 84 F. 2d 415; *Nelson* v. *Helvering*, 296 U. S. 374; *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378; *Helvering* v. *Watts*, 296 U. S. 387.*

But in these cases there was involved no statutory requirement for the retention of an interest of any specified amount in the transferee, such as that now under consideration. In *Muskegon Motor Specialties Co.* v. *Commissioner*, 6 Cir., 134 F. 2d 904, however, such a statute was thought to be satisfied although a majority interest in one of two transferring corporations was seemingly not preserved in the transferee. In *C. I. R.* v. *Bankers Farm Mortgage Co.*, 7 Cir., 145 F. 2d 772, upon which the taxpayer also relies, the court used the following language in construing the phrase "or any of them" in the section now under examination. (p. 774)

> " *** We construe the modifying phrase to mean that if A and B held 90% at the beginning of the reorganization and A held 60% after the reorganization was effected, there would be a statutory continuity of interest. No other good reason for the existence of the modifying phrase 'or any of them' has been suggested or occurs to us. It cannot be ignored in applying this statutory test to the facts in the instant case."

It does not appear, however, that the court intended to rule that the parties who retain a 50 per

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*It is pointed out in Paul, Studies in Federal Taxation (3d Ser. 1940) 103-4 that in the *Watts* case the transferor retained 45.34 per cent. interest, in the *Nelson* case 38.46 per cent., and in the *Minnesota Tea* case 55.85 per cent.

cent. interest need not have had so large an interest before the transfer, because in that case the creditors, through whose efforts the reorganization was accomplished, seem to have had more than a 50 per cent. interest at both points of time. Moreover, the court did not overrule or even mention earlier decisions in which under similar statutory provisions the need for the existence of the specified interest both before and after the reorganization process is plainly indicated. Thus in *Monarch Electric and Wire Co.* v. *Commissioner*, 7 Cir., 38 F. 2d 417, 418-9, it was said:

> "* * * In our judgment the working of the statute is not ambiguous in this particular. It explicitly says that 'if an interest or control of 50 per centum or *more* remains in the same persons, or *any of them*,' (italics ours) then the statute applies. Before the reincorporation Deutsch, it is true, owned and controlled more than 50 per cent. of the stock; but it is also true that he, with either one or more of the Schwabs, at that time owned and controlled more than 50 per cent. of the stock. After the reincorporation we find the persons holding the stock in the new corporation are identical with the stockholders in the old, and that Deutsch, with either one or more of the Schwabs, still owns and controls more than 50 per cent. of the stock of the new corporation; and this brings the transactions squarely within the statute."
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> * * *
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> "* * * To my mind the evident intent of the section is, that if, after any such change, any person or persons, singly or collectively, shall

hold in the reorganized business as much as 50 per cent. of the entire interest or control therein, and are the same person or persons who, singly or collectively, held as much as 50 per cent. interest or control in the old business, the reorganized business shall not, for the purpose of determining invested capital, be allowed a greater value on any of its assets than would have been allowed, upon the same assets, to the old business had there been no reorganization.

"Here not only 50 per cent., but the entire ownership—and so the entire control or interest in the consolidated business—is in the same persons, and in none others, as was the entire interest and control in the old business."

The holding of this case was expressly reaffirmed by the Seventh Circuit in *Fairbank Court W. Groc. Co.* v. *C. I. R.*, 84 F. 2d 18. To the same effect is the decision in *Rex Mfg. Co.* v. *Commissioner*, 7 Cir., 102 F. 2d 325; see also *Republic Steel Corp.* v. *United States*, Ct. Cl., 40 F. Supp. 1017.

The decision of the Tax Court is therefore

Affirmed.

OPINION OF UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT IN MUSKEGON MOTOR SPECIALTIES CO. v. C. I. R.

HICKS, Circuit Judge.

The petitioner, Muskegon Motor Specialties Company, seeks a review of a decision of the Board of Tax Appeals redetermining deficiencies in its income and excess profits taxes for 1934 in the respective amounts of $5,596.51 and $2,035.10.

Decision turns upon determination of the basis for computing depreciation of petitioner's assets. If the basis was cost at the time of their acquisition, petitioner should prevail; but if the net unrecovered cost to the two companies from which the assets were acquired, the Board's decision must stand.

In 1928 there existed in Michigan the L. O. Gordon Manufacturing Company, engaged in the manufacture of cam shafts and herein called Gordon, with outstanding capital stock of 2,000 shares having a par value of $100, and the Muskegon Motor Specialties Company, engaged in a similar business, herein called Muskegon Michigan, with outstanding capital stock of 4,500 9/10 shares of no par value. Of Gordon's 2,000 shares, L. O. Gordon, its president, and his wife owned 560 shares; and of Muskegon Michigan's 4,500 9/10 shares, 2,228 were owned by Flanders Investment Company, a personal holding company of Fred L. Flanders, Muskegon Michigan's president.

On November 7, 1928, a circular letter was sent to the stockholders of Muskegon Michigan, setting

out a plan for consolidating Gordon and Muskegon Michigan and stating that it had been unanimously agreed upon by the officers and directors of both companies, by all the stockholders of Gordon, and by 96% of the stockholders of Muskegon Michigan. All of Muskegon Michigan stockholders must ultimately have agreed, since all participated in the merger.

On November 24, 1928, petitioner, a Delaware corporation, was organized "for the purpose of effecting a consolidation of the businesses" of Gordon and Muskegon Michigan with an authorized capital of 62,500 no par Class A shares, carrying a $2.00 dividend, and 187,500 of no par common. L. O. Gordon was elected petitioner's president and Flanders its treasurer and chairman of the board.

Cash was acquired from the sale to three banks of all the Class A shares and 15,000 of the common stock for $1,385,000; and from the declaration later by Gordon of a $60,000 dividend which had already been assigned to petitioner.

On November 27, 1928, petitioner organized two subsidiary corporations, the Midland Investors, Inc., herein called Midland, and Norton Securities Company, herein called Norton, with stock issues of 5,000 and 3,750 no par shares, respectively. Petitioner purchased the entire issue of Midland for $45 per share, and of Norton for $100 per share.

Using the balance of its cash, some of its own common stock and the entire issues of Midland and Nor-

ton, petitioner acquired the entire outstanding stock of Gordon and Muskegon Michigan. To aid petitioner in this purchase, L. O. Gordon had previously obtained options upon the 1,440 shares of Gordon stock which he and his wife did not own; and the Flanders Investment Company, and other stockholders of Muskegon Michigan, deposited their shares with the Union National Bank of Muskegon Michigan for exchange for cash and stock of petitioner.

On December 6, 1928, these acquisitions were consumated as follows:

Petitioner acquired all of the shares of stock of Gordon in the following detailed manner,—from Gordon and wife 560 shares for which petitioner paid $15,492.40 in cash; 5,000 shares of Midland and 35,000 of its own common; from the other stockholders the 1,440 remaining shares of Gordon for $433,507.60 in cash, Gordon's options thereon having been assigned to petitioner.

On the same date petitioner acquired from Flanders Investment Company 2,228 shares of Muskegon Michigan for $6,652.23 in cash, the 3,750 shares of Norton, and 37,118 1/3 shares of its own common; and from the remaining stockholders of Muskegon Michigan the 2,272 9/10 remaining shares for $389,346.77 in cash, and 37,881 2/3 shares of its own common.

In making these acquisitions petitioner had issued all of its Class A stock and 125,000 of the 187,500

authorized shares of its no par common, the remaining 62,500 shares of its no par common being reserved for conversion of the Class A shares. Before these acquisitions on December 6, 1928, no former Gordon shareholder had owned any Muskegon Michigan stock, and no former Muskegon Michigan shareholder had owned any Gordon stock. Thereafter no former Gordon or Muskegon Michigan shareholder owned any of petitioner's Class A or any of the 15,000 shares of no par common stock which it had sold to the banks; but the combined holdings of petitioner's common stock by former Gordon and Muskegon Michigan shareholders totaled 110,000 shares.

On January 23, 1929, special meetings of the stockholders and directors of Gordon and Muskegon Michigan were held, which authorized a conveyance of all the properties and assets of each corporation to petitioner upon the assumption by the latter of all the debts and liabilities of each and directing thereafter the dissolution and surrender of the charter of each.

Petitioner claims that in determining depreciation it is entitled to the basis of cost to it of the depreciable properties acquired from Gordon and Muskegon Michigan. This cost, for the depreciable assets acquired from Gordon, was $364,684.10, and for those acquired from Muskegon Michigan, $490,896.88. The Board held that petitioner must use the basis of its predecessors, that is, the unrecovered cost to them, on the date of the transfer, of

their assets to petitioner. The unrecovered cost of the Gordon assets on that date was $214,675.51 and of the Muskegon Michigan assets was $23,369.63.

Sec. 114(a) of the Revenue Act of 1934, 26 U. S. C. A. Int. Rev. Acts, page 701, provides that the basis for depreciation in respect of any property shall be the adjusted basis provided in Sec. 113(b) thereof, 26 U. S. C. A. Int. Rev. Acts, page 700. This section is made to depend upon Sec. 113(a) which provides "the basis of property shall be the cost of such property" with certain exceptions, number "(12)" of which is relied upon by the Commissioner. This Sec. 113(a) (12) is as follows: "(12) Basis established by Revenue Act of 1932. If the property was acquired, after February 28, 1913, in any taxable year beginning prior to January 1, 1934, and the basis thereof, for the purposes of the Revenue Act of 1932 was prescribed by section 113(a) (6), (7), or (9) of such Act, then for the purposes of this Act the basis shall be the same as the basis therein prescribed in the Revenue Act of 1932." This subsection (12) must control in determining the amount of petitioner's deficiencies in income and excess profits taxes for 1934.

The Commissioner's contention is that Sec. 113(a) (7) controls the situation. Pertinent portions thereof follow: "(7) Transfers to corporation where control of property remains in same persons. *If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or*

control in such property of 50 percentum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. * * *" (Italics ours.)

A "reorganization" is defined in Sec. 112(i) (1) (A) of both the 1928 and 1932 Revenue Acts, 26 U. S. C. A. Int. Rev. Acts, pages 379, 513, as among other things, "a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation)."

Petitioner concedes that the transactions hereinbefore described fall within the literal language of this definition of a reorganization, since petitioner had acquired all of the stock of Gordon and Muskegon Michigan; but insists that under decisions of the Supereme Court and of this and other courts, there must be found in addition a continuity of interest betwen the old and new corporations, and that the interest of the transferors or their stockholders must represent a substantial part of the value of the thing transferred. Petitioner, among other cases, cites Helvering v. Minnesota Tea Co., 296 U. S. 378, 56 S. Ct. 269, 80 L. Ed. 284; Miller v. Comm'r., 6 Cir., 84 F. 2d 415; Banner Mach. Co. v. Routzahn,

6 Cir., 107 F. 2d 147; Mascot Stove Co. v. Comm'r., 6 Cir., 120 F. 2d 153, and Templeton's Jeweler's Inc., v. United States, 6 Cir., 126 F. 2d 251.

Petitioner further concedes that there was "some continuity of interest" between Muskegon Michigan stockholders and itself since each of the Muskegon Michigan stockholders received stock in petitioner but denies that the continuing interest represented a substantial part of the value of the thing transferred. We are not in accord.

In Miller v. Comm'r., supra, we pointed out that each case must in its final analysis rest upon its own peculiar facts. We said substantially the same thing in Banner v. Comm'r., supra. In the Miller case we ruled that a controlling interest in the transferee corporation was not necessary to reorganization. In Le Tulle v. Schofield, 308 U. S. 415, 60 S. Ct. 313, 84 L. Ed. 355, the court in reviewing several previous decisions as to what constituted a substantial stake of the transferor in the new enterprise, pointed out that such a stake was thought to be retained where a large proportion of the consideration was in common stock of the transferee, citing the Minnesota Tea case, supra.

Here, in addition to cash and other stock, the Muskegon Michigan stockholders received 60% of the issued (40% of the authorized) common stock of a corporation whose transferors had had consolidated earnings averaging over $240,000 for each of the three years before their union in petitioner. Moreover, dividend commitments of the new corpo-

ration, which take precedence over common stock, were only $125,000 per year. We think that these potential earnings, plus a large share in the control of petitioner as represented by the common stockholdings, represented substantial value.

Gordon is nearer the border line. Of the 2,000 shares of Gordon which were transferred by stockholders to petitioner, 1,440 were paid for in cash. Gordon and wife, representing 560 shares of Gordon, became stockholders in petitioner. However, their common stockholdings therein, over and above payments to them in cash and other stock, were 35,000 shares. This represented more than 25% of petitioner's issued common stock and 18 2-3% of the authorized stock. Its potential earnings and the voice it gave its owners in management, coupled with L. O. Gordon's presidency of petitioner, constitute a "substantial stake" therein.

We conclude that these transactions establish a "reorganization" within the meaning of Sec. 112(i) (1) (A).

We come now to the question, whether under Sec. 113(a) (7), "immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them." As we have noted, there was no interlocking ownership betwen Gordon and Muskegon Michigan prior to the transfer. And petitioner, taking each transferor company separately, points out that after the transfer Gordon stockholders owned but 18 67/100% of the authorized common stock of peti-

tioner, and the Muskegon Michigan stockholders but 40%.

We confine our attention to the question whether the transferor stockholders had a 50 per centum *control* of the property of the petitioner immediately after the transfer. In the first place we seriously doubt, as petitioner urges, that the two sets of stockholders of the transferring corporations, must be separately considered in answering the question whether this 50 per centum of control existed. The statute enacts that the "control" must have "*remained* in the same persons or any of them." (Italics ours.) The use of the word "remained" connotes a continuity of control both before and after the transfer. And if such control continued, it obviously must have continued or "remained" in those persons who had had it before, namely, Gordon and Muskegon Michigan stockholders. In other words, control "remained" in the stockholders of the transferee corporation if they had been owners of common stock in one of the transferor corporations, irrespective of the fact that they may or may not have been stockholders in both. If transferor stockholders, which includes those of Gordon and Muskegon Michigan, collectively owned 50 per centum of the common stock of the new corporation, we think the statute is satisfied. Fairbanks Court W. Groc. Co. v. Comm'r., 7 Cir., 84 F. 2d 18. But the statute does not enact that 50 per centum control must remain in the "same persons," that is, in all of them; its terms are met if that quantum of control remains in "any of them." It matters not that all of the

stockholders of the old corporations did not become common stockholders of petitioner. If "any" who were stockholders in Gordon plus "any" who were stockholders in Muskegon Michigan immediately after the transfer collectively control 50 per centum of petitioner, the statute is met. This is clearly so on the facts since former stockholders of Gordon own 18 2/3% of petitioner's common stock, and former stockholders of Muskegon Michigan own 40% of petitioner's stock, aggregating more than 50 per centum thereof.

But petitioner urges that even if the statute be satisfied as to common stock ownership that is not sufficient. The argument is that any stockholder, common or otherwise, because of his power to veto various arrangements in a sense has "control" over the property of the corporation; and that therefore the "control" called for in the statute must be a 50 per centum control of all stock, Class A as well as common. Petitioner cites Sec. 112(j) of the Revenue Act of 1932, 26 U.S.C.A. Int. Rev. Acts, page 514, in support of its position, wherein it is enacted, "the term 'control' means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation." The answer to this proposition is that Sec.112(j) expressly limits its coverage to Sec. 112. See Bickford's Inc., v. Helvering, 2 Cir., 98 F. 2d 568, wherein the same contention was raised and rejected.

Finally, the taxpayer urges that the real transferors were the stockholders and not the corpora-

tions; and that therefore the transferors' cost basis should be increased by the amount of gain recognized to them. The answer to this is implicit in all that we have just said. It is sufficient to say in amplification that the facts do not support such a view of this transaction. It is quite evident that no event has occurred which placed the stockholders, as against the transferor corporations, in control of these assets. So far as the record reveals, no stockholders' committees were active. The transaction seems to us to be what it purports to be, namely, a reorganization through intercorporate action. Compare Bondholders Committee v. Comm'r., 315 U. S. 189, 62 S. Ct. 537, 86 L. Ed. 784.

The decision of the Board of Tax Appeals is affirmed.

INDEX

CITATIONS

761868—47——1

In the Supreme Court of the United States

OCTOBER TERM, 1947

No. 328

ADAMSTON FLAT GLASS COMPANY, PETITIONER
v.
COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 130–150) is reported in 7 T. C. 493. The opinion of the Circuit Court of Appeals (R. 152–166) is not yet reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on June 5, 1947. (R. 166.) The petition for a writ of certiorari was filed on September 5, 1947. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the taxpayer-corporation is entitled under Sections 113 and 114 of the Internal Revenue Code to use the Clarksburg Glass Company's basis for depreciation with respect to properties which formerly belonged to that company and which were thereafter sold to the taxpayer by Pittsburgh Plate Glass Company in 1926. The answer depends upon whether there was a "reorganization" of Clarksburg Glass Company within the meaning of Section 203 (h) of the Revenue Act of 1926, and whether, if there was a reorganization, a 50 percent interest or control in such property remained in the same persons or any of them, as required by Section 113 (a) (7) (A) of the Code.

STATUTES AND REGULATIONS INVOLVED

These appear in the Appendix, *infra*, pp. 21–25.

STATEMENT

The findings of the Tax Court are extensive and are set out in full at pages 131–145 of the record. For present purposes, the facts may be abridged, as follows:

On June 18, 1926, the taxpayer was incorporated under the laws of West Virginia. (R. 131.)

During the year 1924 the Clarksburg Glass Company (hereinafter sometimes called Clarksburg Company), a West Virginia corporation of Clarksburg, West Virginia, was in need of additional funds with which to finance its opera-

tions, which had been unsuccessful for several years. On August 27, 1924, that company entered into an agreement with the Pittsburgh Plate Glass Company (hereinafter sometimes called Pittsburgh Company), whereby the Pittsburgh Company agreed to advance to Clarksburg Company the sum of $70,000 to be used to pay its current notes and account, and also agreed to advance further sums at its discretion from time to time in the aggregate amount of not to exceed $100,000. By the agreement of August 27, 1924, and in consideration of the financial and operating assistance rendered, the Pittsburgh Company became actively interested in the operation of the Clarksburg Company and received an option, never exercised, to purchase the assets of Clarksburg, other than raw materials, goods in process and finished products. (R. 131.)

Pursuant to that agreement, $70,000 was borrowed by the Clarksburg Glass Company from the Pittsburgh Plate Glass Company and was repaid to that company in 1925. Also, pursuant to that agreement, the Pittsburgh Plate Glass Company advanced to the Clarksburg Glass Company the sum of $100,000 in September 1924. This was secured by a second mortgage on the Clarksburg properties, and the indebtedness, as of January 1, 1926, was evidenced by three notes all dated June 30, 1925, two in the amounts of $20,000 and $30,000 respectively, due on or before January 1, 1926, and one in the amount of $50,000, due on

or before July 1, 1926. Of this indebtedness $70,000 was endorsed by W. M. B. Sine, president of Clarksburg, personally. (R. 131-132.)

Early in 1925, for reasons of urgent financial expediency, the stockholders of Clarksburg Glass Company and the stockholders of American Sheet Glass Company, another glass company operating in Clarksburg, undertook to effect a merger; and on February 9, 1925, the Clarksburg Flat Glass Company was organized under the laws of West Virginia to take over the properties of the two companies. Shortly thereafter, the Clarksburg Flat Glass Company entered into agreements with Clarksburg and the American Sheet Glass Company whereby Flat Glass obtained an option, to be exercised within six months, to acquire the respective properties in exchange for shares of its stock and the assumption of liabilities. By July 7, 1925, Flat Glass had realized approximately $200,000 from the sales of its stock which was expended in payment of obligations of the Clarksburg and American Companies. It had received notes of Clarksburg totaling $171,800. The contemplated merger was never completed, since the parties were unable to raise the necessary funds. Efforts to effect a merger between the companies continued without success until January of 1926. (R. 132-133.)

On January 1, 1926, Clarksburg defaulted in payment of its notes totaling $50,000 due Pittsburgh on or before that date. The additional

obligation in the face amount of $50,000 also became due as a result of an acceleration clause. On January 20, 1926, Pittsburgh instituted a suit in the District Court of the United States for the Northern District of West Virginia for the appointment of a receiver to foreclose its deed of trust. H. E. Davisson was appointed receiver by the court for the property and assets of Clarksburg Glass Company. He operated the company from January 22 to May 22, 1926, under the direction and supervision of W. M. B. Sine, president of the company. Sine recommended the appointment of H. E. Davisson as receiver. During this period, January 22 to May 20, 1926, Sine was negotiating to raise funds to retain the property and assets of the Clarksburg Glass Company. (R. 133–134.)

On February 9, 1926, at the annual meeting of the stockholders of Clarksburg Glass Company, the president reported the institution of the suit by Pittsburgh, and that the officers and directors had been unable to raise money sufficient to pay the debt and prevent foreclosure, and suggested that the stockholders subscribe funds sufficient to purchase the claim. Subscriptions having been solicited, it was found that sufficient funds could not be obtained at that meeting and a committee consisting of Sine and two others was appointed to arrange a general meeting of stockholders of Clarksburg Glass Company, Clarksburg Flat Glass

Company, and American Sheet Glass Company for the purpose of determining what action should be taken, and taking any feasible action, to protect the stockholders of Clarksburg Glass Company. On April 12, 1926, a committee for the stockholders of the Clarksburg Glass Company and the Clarksburg Flat Glass Company addressed to their stockholders a report in which it was stated that it was the opinion of the committee that the only practical way of protecting the investment made in the stock of those companies was for the stockholders to subscribe to the capital stock of a new corporation to be formed, which would attend the sale of the assets of the Clarksburg Glass Company when and if the sale was held, and to acquire the assets at the sale if they could be had at a price that would insure the subscribers an adequately capitalized business. (R. 134–135.)

On April 16, 1926, judgment was rendered in the equity suit in favor of Pittsburgh for the amount due and providing that in default of payment within five days the real and personal property of the Clarksburg Glass Company be sold in satisfaction of the lien debt to Pittsburgh Plate Glass Company and subject to the prior lien of the first mortgage. (R. 136.)

In April and May, 1926, the Pittsburgh Company wrote letters to Mr. Steptoe, their counsel, excerpts from which appear on pages 136–138 of the record. In these letters it is stated that if Sine and his associates could purchase the prop-

erty at the foreclosure sale, that would be satisfactory since Pittsburgh did not care to acquire the property and would only do so to protect its interests.

A sale was made of the property and assets of the Clarksburg Glass Company on May 20, 1926, by commissioners appointed for that purpose, to Pittsburgh for the sum of $100,000, and the sale was confirmed by the court on May 22, 1926. Neither Sine nor his associates bid on the property, although Sine was present at the sale. Pittsburgh received a deed dated May 26, 1926, which recited that the consideration for the transfer was the sum of $100,000 of which amount $33,500 was paid in cash on the day of sale, and the residue, evidenced by a note in the sum of $66,500 and bearing interest at 6 percent per annum, was to be paid on or before December 31, 1926. The $33,500 cash payment was from funds of Pittsburgh Plate Glass Company. The day before the receiver's sale, Sine deposited with the attorneys from Pittsburgh Plate Glass Company $33,500, to show good faith that he and his associates would be taking over the property, and subject to the final transaction being carried out. (R. 138–139.)

On June 3, 1926, the Pittsburgh Plate Glass Company wrote a letter to Sine, offering to sell

761868—47——2

the property and assets of the Clarksburg Glass Company on the following basis (R. 139–140):

> * * * that you pay to us the full amount of our claim against the Clarksburg Glass Company and repay or reimburse us for all payments, costs, expenses and all other "out of pocket" amounts arising from the foreclosure proceedings. This will be substantially as follows:
>
> You will repay to us the cash payment of \$33,500, with interest, that we paid to the special commissioners appointed by the Court, plus the principal of \$100,000 and accrued interest on notes due us of the Clarksburg Glass Company, and all of the costs of said suit, sale and receivership, including our counsel fees incurred therein and any deficit in the Receiver's account. You are further to pay all taxes accrued or to accrue against the property and the first mortgage note, with interest (amount \$20,000), now past due.
>
> This offer must be accepted within thirty days from this date and \$80,000 paid to us by you thereupon, and within thirty days after acceptance additional cash to reduce the total of your indebtedness to \$66,666.66, for which we will accept your notes, with interest at six percent, to be secured by a mortgage on the property substantially in form and effect as the mortgage heretofore given us by the Clarksburg Glass Company.
>
> If this offer is not accepted within thirty days from date, it becomes null and void.

> If accepted, other details and more exact figures will be compiled immediately together with necessary adjustments.

On June 15, 1926, Sine wrote a letter to the Pittsburgh Plate Glass Company, accepting the offer of June 3, 1926. Such acceptance was made on behalf of Adamston Flat Glass Company,[1] the taxpayer herein. (R. 140.)

On June 18, 1926, the Adamston Flat Glass Company, the taxpayer herein, was chartered. The authorized capital stock of the taxpayer was $200,000, divided into 2,000 shares of par value of $100 each. (R. 140.)

On June 29, 1926, settlement was effected between Pittsburgh and taxpayer, under the terms of which Pittsburgh received the sum of $153,969.85, which consisted of the sum of $87,303.19 in cash and two notes of $33,333.33 each, payable in one and two years respectively. A deed conveying the property to the taxpayer was executed. (R. 141–142.)

On September 15, 1926, 1,500 shares of capital stock of Adamston Flat Glass Company were issued to 43 stockholders. The stockholders acquired their stock by purchase. Of the 79 stockholders of Clarksburg Glass Company only 10 subscribed for 729 shares of the 1,500 shares of stock of Adamston Flat Glass Company. J. H.

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[1] The prospective new company had been given that name about April 1926.

Fox, trustee for Pittsburgh Plate Glass Company, owned 4,257 shares of stock of Clarksburg Glass Company, but no stock of Adamston Flat Glass Company was subscribed for, purchased, or acquired by, or in trust for Pittsburgh Plate Glass Company. (R. 143.)[2]

On January 20, 1926, the total outstanding capital stock of Clarksburg Glass Company consisted of 18,215 voting and 3,061 nonvoting shares. Of the outstanding capital stock 9,663 shares of voting and 2,482 shares of nonvoting stock were held by persons who were not stockholders of Adamston Flat Glass Company. (R. 143.)

A list of stockholders of Adamston Flat Glass Company who held stock in Clarksburg Glass Company is shown on page 143 of the record.[3]

A list of those direct creditors of Clarksburg who subscribed for the stock of Adamston and became stockholders follows (R. 143):

Name:	*Shares subscribed for and issued*
W. M. B. Sine	507
H. B. Curtin	300
Total	807

[2] Subsequent to the argument in the Circuit Court of Appeals, taxpayer contended for the first time in a memorandum filed with the court that the above finding is incorrect and that twelve stockholders of Clarksburg acquired 754 shares of taxpayer's stock. (See R. 161; Pet. 8.)

[3] Taxpayer now contends that this finding is inaccurate. See footnote 2, *supra*.

Sine also was endorser on $70,000 in notes in default to Pittsburgh Plate Glass Company. (R. 144.)

A list of the stockholders of Flat Glass, the largest unsecured creditor of Clarksburg, who subscribed for the stock of Adamston, and became stockholders, and the number of shares so subscribed and issued, is set out on page 144 of the record.

A list of the stockholders and creditors of Clarksburg who subscribed for the stock of Adamston is set out on page 145 of the record.[4]

The total number of shares of Adamston stock subscribed for and issued originally was 1,500. (R. 145.)

Books and records were opened on June 29, 1926, for what the bookkeeper considered the Adamston Flat Glass Company, as of May 22, 1926. The books contained reference to notes dated June 29, 1926. From May 22 to June 28, 1926, W. M. B. Sine operated the plant under authority from Pittsburgh. (R. 145.)

The Tax Court sustained the Commissioner's determination and held that in computing its income taxes for the years 1940, 1941, and 1942, the taxpayer can not use the Clarksburg Glass Company's basis for depreciation. (R. 150.) The Circuit Court of Appeals affirmed. (R. 166.)

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[4] Taxpayer now contends this list should be corrected to include one more stockholder. See footnote 2, *supra*.

ARGUMENT

Sections 113 and 114 of the Internal Revenue Code (Appendix, *infra*), read together, provide that the basis for depreciation shall be the cost of the property with certain exceptions. One of the exceptions is found in Section 113 (a) (7) (A), and is to the effect that if the property was acquired after December 31, 1917, and in a taxable year beginning before January 1, 1936, by a corporation in connection with a "reorganization," and immediately after the transfer an interest or control in such property of 50 percent or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor.

Section 203 (h) of the Revenue Act of 1926 (Appendix, *infra*), applicable to the transactions here involved, provides in part that the term "reorganization" means "a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation) * * *."

Therefore, in order to use the Clarksburg Glass Company's basis for depreciation, the taxpayer must show both that there was a "reorganization" and that immediately after the transfer the requisite interest or control remained in the same

persons or any of them. The Tax Court assumed, without deciding, that the 50 percent interest or control requirement was satisfied, but decided the case against the taxpayer on the ground that there was no reorganization. (See R. 147.) The Circuit Court of Appeals concluded that there was a reorganization but nevertheless sustained the Tax Court's decision because the transfer did not meet the 50 percent interest or control requirement. We submit that both courts reached the correct result and that there is no adequate basis for certiorari.

A. THE REQUISITE INTEREST OR CONTROL WAS LACKING

Since the taxpayer bases its application for certiorari solely upon the question with respect to the 50 percent interest or control provision of the statute, and that was the point as to which the Circuit Court of Appeals sustained the Tax Court's decision, we will discuss it first. It is our view that the statutory language "remained in the same persons or any of them" is satisfied only if the holders of a 50 percent interest or control in the new corporation acquired that interest or control by virtue of their possession of a 50 percent interest or control in the old corporation. It is not necessary that everybody in the controlling group prior to the transfer participate in it, and the percentages of interest or control after the transfer may be different from what they

were before it, but it is essential to the operation of the statute that persons who collectively had the minimum interest or control immediately prior to the transfer continue collectively to have it thereafter. To this effect, see G. C. M. 7472, IX-1 Cum. Bull. 184, 191-192 (1930); I. T. 2662, XI-2 Cum. Bull. 41, 42-43 (1932); *Monarch Electric & Wire Co.* v. *Commissioner,* 38 F. 2d 417 (C. C. A. 7); *Fairbanks Court W. Groc. Co.* v. *Commissioner,* 84 F. 2d 18 (C. C. A. 7), certiorari denied, 299 U. S. 582; *Rex Mfg. Co.* v. *Commissioner,* 102 F. 2d 325 (C. C. A. 7); *Republic Steel Corp.* v. *United States,* 40 F. Supp. 1017 (C. Cls.).

And if that be so, then clearly there is absent in this case the requisite carry-over of the minimum interest or control and the Circuit Court of Appeals below correctly so held, pointing out (R. 161) that neither the creditors nor the shareholders separately considered held a 50 percent interest before the transfer, and that the two classes may not be combined for the purposes of the statute.

The Circuit Court of Appeals took the view that in the circumstances of this case the stockholders were the real proprietors of the old company and they alone should be considered in determining the question. In the petition for certiorari the taxpayer accepts that view (Pet. 8), and urges (Pet. 10, 14-19, 20, 22, 25-26) that the decision of the Circuit Court of Appeals here is in conflict with *Muskegon Motor Specialties Co.* v. *Commis-*

sioner, 134 F. 2d 904 (C. C. A. 6), certiorari denied, 320 U. S. 741. We submit that taxpayer is wrong and that there is no conflict between the decisions. In the *Muskegon* case the court was concerned with the peculiar situation arising where a new company acquires the assets of two transferor companies. In that case all of the stockholders of one of the transferor companies, Muskegon Michigan, participated in the reorganization, and they emerged as the holders of 60 percent of the issued (40 percent of the authorized) common stock of the new company. As to the other transferor company, the Gordon Company, it appears that one Gordon and wife owned 28 percent of its stock and he had options on the balance. Gordon and wife participated in the reorganization and acquired over 25 percent of the issued (18⅔ percent of the authorized) common stock of the new company. Gordon assigned his options to the new company which acquired for cash the shares covered by the options. After the stock of the two old companies had been thus acquired, the new company took over their assets. The cost of the depreciable assets acquired from Muskegon Michigan was about $490,000 and the cost of those acquired from the Gordon Company was $364,000. The new company claimed that it was entitled to use this cost as the basis for depreciation, but the Commissioner determined that it must use the basis of its predecessors and

the Board of Tax Appeals upheld the Commissioner. Upon appeal by the taxpayer, the Circuit Court of Appeals concluded (pp. 907–908) that the 50 percent interest or control requirement of the statute was satisfied because the transferor stockholders collectively held more than 50 percent of the authorized common stock of the new corporation after the transfer. In so holding the court cited the decision of the Seventh Circuit in the *Fairbanks* case, *supra.* It is true that the court does say that it matters not that all of the stockholders of the old corporations did not become common stockholders of the taxpayer, and that if any who were stockholders in Gordon plus any who were stockholders in Muskegon Michigan immediately after the transfer collectively controlled 50 percent of taxpayer, the statute is met. But that language must be viewed in the light of the facts which show that the participating stockholders, collectively considered, had an interest of more than 50 percent in the combined properties of the two transferor corporations.

The taxpayer in the instant case says (Pet. 15) that the Circuit Court of Appeals below recognized a conflict between its decision and the *Muskegon* case. We do not think that this is so. True, the court did say (R. 164) that in the *Muskegon* case a majority interest in one of the two transferring corporations was seemingly not preserved in the transferee, but that remark does not indicate

that the court would have reached a conclusion different from the Sixth Circuit in the *Muskegon* case if the peculiar facts of that case had been before it. There is a material difference between a case like the instant one where there was only one transferor corporation and a case like *Muskegon* where there were two. Certainly the opinion of the Fourth Circuit in the instant case is not at variance with the view of the court in the *Muskegon* case when considered in the light of the actual facts presented.

The applicable authorities are thoroughly considered by the Circuit Court of Appeals in its opinion (R. 164–166) and its conclusion that in circumstances such as here presented the statutory requirement has not been satisfied is amply supported by them.

B. THERE WAS NO REORGANIZATION

In addition to the foregoing, we submit that there was no reorganization in this case; that the Tax Court correctly so held, and to the extent that the opinion of the Circuit Court of Appeals is at variance with this, it is wrong. The Tax Court thought (R. 147) that there was not sufficient continuity between the equity ownership of the old and new companies to justify the claim of reorganization. Here the old company was con-

cededly insolvent [5] and in the hands of an equity receiver, and there was apparently nothing left for the stockholders; and since the secured creditors were accorded full priority, it would seem that the unsecured creditors should be treated as the equity owners. *Helvering* v. *Limestone Co.,* 315 U. S. 179; *Montgomery Building Realty Co.* v. *Commissioner,* 7 T. C. 417 (Commissioner's Acquiescence, 1946–2 Cum. Bull. 4). The Tax Court pointed out that only the holders of a relatively insignificant amount of the total claims against the old company emerged as stockholders of the new, and held that this was not enough to satisfy the continuity of interest test as to a reorganization. *Pinellas Ice Co.* v. *Commissioner,* 287 U. S. 462; *Helvering* v. *Limestone Co., supra.*

Moreover, there was a receiver's sale of the old company's assets to the Pittsburgh Company, and the Tax Court thought that this left Pittsburgh in the position of an independent owner and effectively broke any continuity that might otherwise have existed. *Bondholders Committee* v. *Commissioner,* 315 U. S. 189, 192–193; *Cushman Motor Works* v. *Commissioner,* 130 F. 2d 977, 981 (C. C. A. 8), certiorari denied, 318 U. S. 756. The Tax Court's conclusion that the transfer to Pittsburgh was not merely a step in a reorgani-

[5] The taxpayer so conceded in the Circuit Court of Appeals, and both of the courts below assumed that the old company was insolvent. (R. 162.)

zation, and that Pittsburgh should be treated as an independent owner, seems neither arbitrary nor unreasonable and it is supported by the evidence which is summarized in the opinion. (R. 149.) Accordingly, it should have been accepted by the Circuit Court of Appeals (*Dobson* v. *Commissioner,* 320 U. S. 489; *Bedford* v. *Commissioner,* 150 F. 2d 341, 343 (C. C. A. 2); *Heller* v. *Commissioner,* 147 F. 2d 376, 378 (C. C. A. 9), certiorari denied, 325 U. S. 868), even though reasonable men might differ as to the factual inferences and conclusions to be drawn from the evidence. *Commissioner* v. *Scottish American Co.,* 323 U. S. 119, 123–124.

Finally, it will be noted that as pointed out in the Tax Court's opinion (R. 147), there was no exchange in the instant case and all of the stock of the new company was issued for cash. This certainly indicates that the old company was closed out as a losing venture and the new company was financed through fresh investment so that there was not a reorganization in any real sense. *Helvering* v. *Cement Investors,* 316 U. S. 527, 533.

In the circumstances, we submit that the Circuit Court of Appeals and the Tax Court both reached the right result in the instant case, and there is no occasion for any further review.

CONCLUSION

The decision is correct; there is no conflict; and the petition should be denied.

Respectfully submitted.

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SEPTEMBER, 1947.

APPENDIX

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 203.

*   *   *   *   *

(h) As used in this section and sections 201 and 204—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

(i) As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

Internal Revenue Code:

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(7) *Transfers to Corporation.*—If the property was acquired—

(A) after December 31, 1917, and in a taxable year beginning before January 1, 1936, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, * * * then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. * * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinbefore provided.

* * * * *

(26 U. S. C. 1940 ed., Sec. 113.)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) *Basis for Depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose

of determining the gain upon the sale or other disposition of such property.

*   *   *   *   *

(26 U. S. C. 1940 ed., Sec. 114.)

Treasury Regulations 69, promulgated under the Revenue Act of 1926:

ART. 1577. *Definitions.*—The term "reorganization," as used in sections 201, 203, and 204 means—

(1) A merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation),

(2) A transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred,

(3) A recapitalization, or

(4) A mere change in identity, form, or place of organization, however effected.

The term "a party to a reorganization" as used in sections 201, 203, and 204 includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation. This definition is not an all-inclusive one, but simply enumerates certain cases with respect to which doubt might arise.

A person is, or two or more persons are, "in control" of a corporation, within the meaning of section 203, when owning—

(1) At least 80 percent of the voting stock, and

(2) At least 80 percent of the total number of shares of all other classes of stock of the corporation.

As used in section 203, as well as in other provisions of the statute, the conjunction "or" is used to denote both the conjunctive and the disjunctive, and the singular is used to include the plural. For example, the provisions of article 1574 are complied with if "stock and securities" are received in exchange as well as if "stock or securities" are received, and if securities in the same corporation, together with securities in another corporation a party to the reorganization or in other corporations parties to the reorganization, are received in exchange.

Treasury Regulations 111, promulgated under the Internal Revenue Code: [1]

SEC. 29.113 (a) (7)-1. *Property Acquired by Corporation in Reorganization after December 31, 1917.*—Section 113 (a) (7) sets forth the conditions under which the basis of property acquired by a corporation after December 31, 1917, in connection with a reorganization as defined in section 112 is the same as it would be in the hands of the transferor, increased or decreased as therein provided in the amount of gain or loss recognized to the transferor under the applicable revenue law. In the case of

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[1] Treasury Regulations 111 are applicable only to years beginning after December 31, 1941. Treasury Regulations 103, also promulgated under the Internal Revenue Code, are applicable to earlier years beginning after December 31, 1938. Sections 19.113 (a) (7)-1, 19.113 (b) (1)-1, and 19.114-1, do not differ from the corresponding provisions of Treasury Regulations 111, above quoted, in any material respect.

property so acquired in a taxable year beginning prior to January 1, 1936, such basis is applicable only if immediately after the transfer there remained in the same persons or any of them an interest or control in such property of 50 percent or more. * * *

* * * * *

SEC. 29.113 (b) (1)–1. *Adjusted Basis: General Rule.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property is the cost of such property or, in the case of such property as is described in section 113 (a) (1) to (21), inclusive, the basis therein provided, adjusted to the extent provided in section 113 (b).

The cost or other basis shall be properly adjusted for any expenditure, receipt, loss or other item, properly chargeable to capital account, including the cost of improvements and betterments made to the property. * * *

* * * * *

SEC. 29.114–1. *Basis for Allowance of Depreciation and Depletion.*—The basis upon which exhaustion, wear and tear, obsolescence, and depletion will be allowed in respect of any property is the same as is provided in section 113 (a), adjusted as provided in section 113 (b), for the purpose of determining the gain from the sale or other disposition of such property, * * *

U. S. GOVERNMENT PRINTING OFFICE: 1947

INDEX

SUBJECT INDEX

TABLE OF CASES CITED

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, A. D. 1947

No. 328

ADAMSTON FLAT GLASS COMPANY,
A CORPORATION, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

REPLY BRIEF FOR PETITIONER.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The opinion of the Circuit Court in this case has been reported since the filing of petitioner's original brief in 162 F(2d) 875.

Petitioner believes there are certain statements made and points raised in respondent's brief in opposition to which a reply should be made, particularly

to call attention to the fact that respondent's brief emphasizes the need for a decision by this Court of the questions presented in the petition.

RESPONDENT'S STATEMENT OF FACTS

While petitioner does not believe that a detailed statement of facts is necessary for the Court's consideration of its petition for a writ of certiorari, petitioner wishes to clarify certain statements made by respondent in his statement of facts.

In the last paragraph starting on page 6 of respondent's brief it is stated that during April and May of 1926, Pittsburgh wrote letters to its counsel in which it was stated that if Sine and his associates could purchase the property at the foreclosure sale, that would be satisfactory since Pittsburgh did not care to acquire the property and would do so only to protect its interests. It is submitted that this statement does not clearly reflect the true status of the negotiations between the representitive of the Clarksburg interests and Pittsburgh conducted prior to the sale or the agreement reached by them prior to the sale. Consideration of all the correspondence between Pittsburgh and its attorneys (R. 35, 56, 57) and the negotiations between Sine and Pittsburgh as related in Sine's testimony (R. 86-92) indicate that Pittsburgh was at all times willing to cooperate in any way to permit the equity owners of the properties to retain said properties as long as its interests were protected, and that an agreement had been reached prior to the sale that this would be accomplished, it being left to the discretion of Pittsburgh's

attorneys whether it could be better accomplished by the Clarksburg interests paying the Pittsburgh indebtedness prior to the sale, bidding the property in at the sale, or letting Pittsburgh buy at the sale and then transfer to the new company formed by the Clarksburg interests. As noted by the Circuit Court in its opinion (R. 156), a plan of reorganization had been agreed upon prior to the sale, and the Tax Court found that the letter from Pittsburgh to its attorneys dated May 17 (R. 137), three days prior to the sale, was the substance of the agreement between Pittsburgh and Sine.

Statements made by respondent in the last paragraph starting on page 9 of its brief and in the footnote on page 10 would indicate that stockholders of Clarksburg acquired only 729 of the 1500 issued shares , or less than 50 per cent. of the stock of petitioner, and that petitioner claims the finding of the Tax Court to that effect is erroneous. Petitioner simply points out that it is apparent from a comparison of the list of stockholders of Clarksburg (R. 62-64) and the list of stockholders of Adamston (R. 67-68), both stipulated to be correct (Paragraph 5 of Stipulation, R. 22, and Paragraph 20, R. 25), that 12 stockholders of Clarksburg acquired 754 shares of Adamston, and that the list of stockholders appearing in paragraph 26 of the Tax Court's findings of fact (R. 143) is incomplete because it omits the names of A. F. Wagner and J. W. Stickley, who together acquired 25 shares of Adamston stock and whose names appear on both the list of Clarksburg stockholders and the list of Adamston stockholders as

stipulated. There is no evidence to the effect that they were not stockholders of both companies.

RESPONDENT'S ARGUMENT A

Respondent does not deny that there is a substantial federal question involved in this case, nor does he deny that the question presented in the petition is one which should be decided by this Court. He merely recites his interpretation of the statutory provision "immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them", urges that the holding of the Circuit Court on this point agrees with his interpretation and is correct, and then attempts to show that this decision is not in conflict with the decision of the Sixth Circuit Court in *Muskegon Motor Specialties Co.* v. *C. I. R.*, 134 F(2d) 904 (Cert. denied 320 U. S. 741, 88 L. Ed. 440).

The basis for respondent's argument that there is no conflict in the two decisions is that there was a peculiar factual situation in the *Muskegon* case that was different from the facts in this case. It is true that the facts in every case cited by both petitioner and respondent are somewhat different but it is difficult to visualize how the Sixth Circuit Court, in view of the language used in its opinion and the conclusion reached in the *Muskegon* case, could have reached the same conclusion the Fourth Circuit Court reached in this case, or how the Fourth Circuit Court could have agreed with the Sixth Circuit Court in the *Muskegon* case in view of its conclusion in this case.

Respondent states that the language of the Sixth Circuit Court in the *Muskegon* case "must be viewed in the light of the facts which show that the participating stockholders, collectively considered, had an interest of more than 50 per cent in the combined properties of the two transferor corporations" (Br. 16). That was true after the property was in the hands of the new corporation, and it is also true in this case. But did any of the stockholders of the new corporation in the *Muskegon* case have a 50 per cent interest in the Gordon properties prior to the transfer? The answer must be that they did not have as much interest in those properties before the transfer as the Adamston stockholders had in the Clarksburg properties prior to the transfer in this case.

Respondent points out (Br. 15) that the cost of the depreciable assets acquired from Muskegon Michigan was about \$490,000 and the cost of those acquired from the Gordon Company was \$364,000. If it is his contention that we must lump the properties of the two corporations prior to the transfer and determine that because 100 per cent. of the ownership of \$490,000 worth of assets and 28 per cent. of the ownership of \$364,000 in assets acquired stock in the new corporation, therefore, more than 50 per cent. of the ownership of the combined properties prior to the transfer was held by stockholders after the transfer, we need only point out that the unrecovered cost, which the commissioner there insisted should be used, of the Gordon properties was about \$215,000 and of the Muskegon Michigan assets about \$23,000 (See Appendix Petitioner's brief p. 55), so that even the

above contention would not be sound. It is submitted that there is no way of reconciling the two cases and that they are conflicting.

Petitioner believes the Commissioner's effort to rationalize the conflict in this case and the *Muskegon* case further emphasizes the need for a decision of the question raised in the petition by this Court. In the *Muskegon* case the Commissioner took the position that there was a sufficient continuity of interest to require use of the transferor's basis, despite the fact that less than 50 per cent. of one of the old companies was carried over into the new company. But there the unrecovered cost was much lower than the cost to petitioner. The Commissioner must take such conflicting positions when the law is uncertain. This uncertainty is mentioned by the Tax Court in *Montgomery Building Realty Co.* v. *C. I. R.*, 7 T. C. 417, wherein the Tax Court held that the Commissioner was wrong. This uncertainty should be resolved by this Court.

RESPONDENT'S ARGUMENT B

Respondent's second point of argument in his brief is that there was no reorganization in this case, a question not presented in the petition for a writ of certiorari nor in a cross petition, and not argued in petitioner's original brief. While petitioner will not discuss the right of respondent to raise this question in argument on the merits of the case, it does not believe this question has any place in a brief filed in connection with a petition for writ of certiorari which does not rely on that point. It is our understanding that an argument in this connection should

be restricted to the question whether the decision of the lower court presents a question which should be reviewed by this Court, and that such question must be properly raised by a petition.

The Circuit Court found that there was a reorganization and, if that decision was erroneous, this Court should be more inclined to grant certiorari than deny it as requested by respondent. Respondent's argument in this connection at this point in the proceedings merely indicates that he, too, believes the Circuit Court erred and is an additional reason for this Court to review the proceedings. If this point is to be considered here, petitioner refers this Court to the reasoning of the Circuit Court on this point as reflected in its opinion (R. 158-159).

CONCLUSION

It is respectfully submitted that there is a conflict in the decisions of the Circuit Courts on the question raised in this petition for writ of certiorari, that this question is a substantial question of federal law, which has not been, but should be, decided by this Court, and that this Court should grant a writ of certiorari in this case to bring the case before it for argument on the merits so that it may properly resolve the uncertainty in the interpretation of the law.

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Of Counsel.